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TREASURY FOR ATUKAROLA

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TAGS: EFIN ECON EINV BU
SUBJECT: BULGARIA?S ECONOMIC OUTLOOK FOR 2005 REMAINS POSITIVE

REFTEL: Sofia 1272

¶1. SUMMARY: The Bulgarian economy showed encouraging growth of 6 percent in the first quarter of 2005, cementing experts? views that the economy will continue to grow in 2005 despite the political turmoil surrounding the formation of the new government. The Bulgarian National Bank (BNB) issued a report the week of July 25 forecasting GDP growth of between 5.4-5.8 percent for 2005. The report affirmed the government?s forecast of moderate inflation of 3.5 percent and acknowledged the Central Bank?s effectiveness in lowering credit growth. With delays in planned privatizations, however, the government?s expectations of 2.2 billion euro in foreign investment this year may turn out to be unrealistic. This, in turn, would increase the risk of a higher current account deficit. The government?s Agency for Economic Analysis and Forecasting has already revised upward its forecasted current account deficit to 8.5 percent of GDP for 2005. END SUMMARY.

BULGARIA?S ECONOMY IS OFF TO A STRONG START

¶2. STRONG GDP GROWTH IN 1Q-2005: Following a record-high GDP growth of 5.6 percent for 2004, GDP increased by 6 percent in the first quarter of 2005 led by an increase in investment (up by 9 percent) and a pick-up in domestic demand (up by 7.3 percent). The private sector, which made up 66 percent of GDP, grew by almost 13 percent, while the public sector was down by 8.6 percent. GDP details show that the strong growth in the first quarter of 2005 reflected a strong outcome for industry (up by 8.2 percent) and services (up by 7.4 percent). Agricultural output declined by 1.7 percent.

¶3. GDP FOR 2005: Central bankers expect high GDP growth rates to continue over the course of the next three quarters, estimating GDP growth for 2005 at 5.4-5.8 percent. The government agreed with the IMF on a revised economic program for 2005 which calls for a slightly lower real GDP growth of 5.5 percent based on higher oil prices and a slowdown in credit expansion.

¶4. MODERATE INFLATION: Despite predicted economic expansion, the BNB?s report affirms the government?s forecast of moderate inflation of 3.5 percent for 2005. The Central Bank, however, cautioned that inflationary pressures may increase due to higher oil prices and the recent flooding in Bulgaria (reftel.) Between January and June 2005, inflation stood at 1.2 percent.

¶5. DECLINE IN CREDIT GROWTH: The BNB?s report concluded that the measures they took earlier this year have been successful in moderating credit growth, and will lead to the targeted credit growth rate of 30 percent (the IMF recommends credit growth rate of 30-35 percent). The growth rate in non-government sector credit slowed to 43.5 percent in June, five percentage points down relative to May 2005.

RISKS: LOWER FDI, HIGHER CURRENT ACCOUNT DEFICIT

¶6. Bulgaria continued to attract foreign direct investment (FDI) in the first months of 2005; however, it was at a lower level - 422 million euro in January-May 2005 - than the 483 million euro for January-May 2004. With uncertainty over the completion of planned privatizations this year, the government?s expectation of 2.2 billion euro in FDI in 2005 ?- of which 900 million euro is to come from privatization and 1,300 million euro from green-field projects ?- may turn out to be high. Meanwhile, the sizeable current account deficit widened once again in the first five months of the year. The 2005 current account deficit may overshoot the government?s projection of 7.6 percent or 1.6 billion euro. The current account deficit increased by 34 percent, from 943.1 million euro in January-May 2004 to 1.26 billion euro in January-May 2005. The government?s Agency for Economic Analysis and Forecasting has revised upward its projected current account deficit to 8.5 percent of GDP.

¶7. COMMENT: Recent economic data indicate that Bulgaria?s economy started the second half of the year on strong

footing. Analysts believe the political stalemate over the formation of a new government is not threatening the positive outlook of the Bulgarian economy, but note that any delay in EU accession could negatively affect the economy. Political considerations, however, have already impeded the successful completion of several privatization deals, which could not only overshadow other government economic successes, but also restrict Bulgaria?s ability to attract new foreign investments. Meanwhile, trade union leaders and business representatives are urging politicians to form a stable coalition government, which will secure a positive review by the European Commission in the fall, and move Bulgaria into the EU in 2007. END COMMENT.

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